

**THE OFFICE OF REGULATORY STAFF**

**DIRECT TESTIMONY**

**OF**

**JOSEPH W. COATES**

**MARCH 4, 2014**



**DOCKET NO. 2013-47-W**

**Application of AAA Utilities, Inc. for Adjustment of  
Rates and Charges for Water Services**

**DIRECT TESTIMONY OF JOSEPH W. COATES**

**FOR**

**THE OFFICE OF REGULATORY STAFF**

**DOCKET NO. 2013-47-W**

**IN RE: APPLICATION OF AAA UTILITIES, INC. FOR ADJUSTMENT  
OF RATES AND CHARGES FOR WATER SERVICES**

**Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION.**

A. My name is Joseph W. Coates. My business address is 1401 Main Street, Suite 900, Columbia, South Carolina, 29201. I am employed by the South Carolina Office of Regulatory Staff (“ORS”) in the Audit Department, as an Auditor.

**Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND YOUR BUSINESS EXPERIENCE.**

A. I received a Bachelor of Science Degree in Finance from the University of South Carolina in August 2008. In February 2009, I began my employment with ORS and have been involved in cases related to the regulation of electric, gas, telecommunications, water and wastewater companies. I have previously testified before the Public Service Commission (“PSC”) in electric rate cases and a fuel case.

**Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?**

A. The purpose of my testimony is to set forth my findings and recommendations resulting from ORS’s examination of the application of AAA Utilities, Inc. (“AAA” or “Company”) in this docket, 2013-47-W. The application was filed on October 29, 2013.

**Q. PLEASE DESCRIBE THE PROCEDURES USED TO PERFORM THE EXAMINATION OF THE APPLICATION OF AAA.**

A. ORS's examination of the Company's Application for Adjustment of Rates and Charges ("Application") consisted of three major steps. In step one, ORS verified that the operating experience, reported by AAA in its application, was supported by AAA's accounting books and records for the twelve months ended December 31, 2012 ("test year"). In the second step, ORS tested the underlying transactions in the books and records for the test year to ensure that the transactions were adequately supported, had a stated business purpose, were allowable for ratemaking purposes, and were properly recorded. Lastly, ORS's examination consisted of adjusting, as necessary, the revenues, expenditures, and capital investments to normalize the Company's operating experience and operating margin, in accordance with generally accepted regulatory principles and prior Commission orders.

**Q. PLEASE IDENTIFY THE EXHIBITS ATTACHED TO YOUR TESTIMONY.**

A. I have attached the following exhibits to my testimony relating to the Application:

- Audit Exhibit JWC-1: Operating Experience & Operating Margin
- Audit Exhibit JWC-2: Explanation of Accounting and Pro Forma Adjustments
- Audit Exhibit JWC-3: Computation of Depreciation Expense Adjustment
- Audit Exhibit JWC-4: Computation of Income Taxes

These exhibits were either prepared by me or were prepared under my direction and supervision in compliance with recognized accounting and regulatory procedures for

1 water utility rate cases. These exhibits show various aspects of AAA's operations and  
2 financial position.

3 **Q. PLEASE DESCRIBE THE FORMAT OF AUDIT EXHIBIT JWC-1 AND**  
4 **ELABORATE ON THE CALCULATIONS.**

5 A. Audit Exhibit JWC-1 details AAA's operating experience and operating margin for  
6 water operations for the test year. The exhibit's format is designed to reflect AAA's  
7 application per book amounts, ORS's proposed accounting and pro forma adjustments  
8 necessary to normalize the results of AAA's test year operations, and the impact of the  
9 Company's proposed increase on the normalized test year.

10 Column (1) details the application per book amounts reported by AAA for the test year.  
11 ORS verified total operating revenues of \$96,442 total operating expenses of \$99,564  
12 interest expense of \$1,539 and net loss for return of (\$4,661) to the Company's books and  
13 records. The per book operating margin of (4.83%) was calculated by dividing net loss for  
14 return by total operating revenues.

15 Column (2) details ORS's proposed accounting and pro forma adjustments designed to  
16 normalize AAA's application per books. An explanation of each adjustment is contained in  
17 Audit Exhibit JWC-2.

18 Column (3) details ORS's calculation of a normalized test year for AAA by adding  
19 columns (1) and (2). After the accounting and pro forma adjustments, net loss for return of  
20 (\$12,045) was computed using total operating revenues of \$89,262, less total operating  
21 expenses of \$101,307. An operating margin of (13.49%) was computed by dividing net loss  
22 for return by total operating revenues.

Column (4) details the proposed increase, recalculated by ORS, and the calculation of taxes associated with the proposed increase. An explanation of each adjustment is contained in Audit Exhibit JWC-2.

Column (5) details the effect of the Company's proposed rate increase by adding columns (3) and (4). Net income for return of \$20,265 was computed using total operating revenues of \$129,664, less total operating expenses of \$109,399. An operating margin of 15.63% was computed by dividing net income for return by total operating revenues.

**Q. PLEASE EXPLAIN THE ADJUSTMENTS IN AUDIT EXHIBIT JWC-2.**

A. For comparative purposes, ORS's and AAA's proposed adjustments are both presented in Audit Exhibit JWC-2.

Adjustments 1-4 – ORS Water and Wastewater Department proposes to normalize water revenue for unmetered and metered customers for the test year. Additionally, adjustments were proposed for miscellaneous revenues and uncollectible accounts. These adjustments were provided by ORS witness Hannah K. Majewski.

Adjustments 5-17 – Operating Expense Adjustments:

ORS's operating expense adjustments total \$1,743:

Adjustment 5 – AAA and ORS propose to increase salaries and wages by \$10,368 to reflect the allocation of administrative personnel salaries related to the water operations. The administrative salary was initially paid by AAA Well Drilling.

Adjustment 6 – ORS proposes to remove (\$470) from purchased power to eliminate the personal electric bills of the owner of AAA.

Adjustment 7 – ORS proposes to remove (\$228) from contractual services for laboratory expenses related to AAA Well Drilling.

1        Adjustment 8 – ORS proposes to remove (\$1,121) from transportation expenses due to  
2        lack of supporting documentation.

3        Adjustment 9 – ORS proposes to decrease insurance expense by (\$3,224). The costs  
4        removed were related to vehicles not used for Company operations (\$1,422), employee  
5        health insurance no longer paid by the Company (\$1,300), and a variance between the  
6        actual cost of the life insurance policy compared to the amount on the general ledger  
7        (\$502).

8        Adjustment 10 – ORS proposes to remove (\$1,000) from repairs due to lack of  
9        supporting documentation.

10       Adjustment 11 – ORS proposes to remove (\$2,287) from miscellaneous expense for  
11       contributions, flowers, and various other costs without supporting documentation. In  
12       addition, ORS also proposes to add \$2,469 for rate case expenses. This amount represents  
13       total expenses of \$7,406 amortized over a 3-year period. These expenses include legal  
14       fees, accounting services, and printing and postage. The net adjustment for miscellaneous  
15       expense is \$182.

16       Adjustment 12 – ORS proposes to annualize depreciation expense and adjust for pro  
17       forma additions. The depreciation rates were provided by ORS's Water and Wastewater  
18       Department. The details of this adjustment are shown in Audit Exhibit JWC-3. ORS  
19       computed total depreciation expense of \$3,045 less the per book amount of \$3,786, for a  
20       total adjustment of (\$741).

21       Adjustment 13 – ORS proposes to adjust for gross receipts and utility/commission taxes.  
22       Total pro forma revenues of \$89,262 were multiplied by the gross receipts factor of

1 .00963081 for an assessment tax of \$860, less the per book amount of \$581, resulting in an  
2 adjustment of \$279.

3 Adjustment 14 – ORS proposes to remove (\$162) from property taxes related to a vehicle  
4 and other equipment not used for Company operations.

5 Adjustment 15 – ORS proposes to adjust payroll taxes associated with adjusted test year  
6 salaries. The payroll taxes include social security and medicare, and federal and state  
7 unemployment taxes. ORS computed payroll taxes of \$1,895, less the per book amount of  
8 \$87, resulting in an adjustment of \$1,808.

9 Adjustment 16 – ORS proposes to remove (\$750) from other taxes and licenses due to  
10 lack of supporting documentation.

11 Adjustment 17 – ORS proposes to reflect state and federal income taxes after accounting  
12 and pro forma adjustments. ORS used 5% for the state rate and 15% for the federal  
13 corporate rate for the calculation of total income taxes. Details of this computation are  
14 shown in Audit Exhibit JWC-4.

15 Adjustment 18 – ORS proposes to remove interest expense associated with the  
16 Company's long-term debt, as this debt was not incurred for the financing of AAA plant  
17 in service.

18 Adjustments 19-22 – Based upon ORS Water and Wastewater Department's calculations,  
19 AAA's proposed rates would produce additional revenues of \$6,090 in unmetered revenue,  
20 \$34,371 in metered revenue, and \$363 in miscellaneous revenue. ORS also calculated a  
21 (\$422) decrease in revenue due to uncollectible accounts. This totals to \$40,402 in  
22 additional revenue for Water Operations. These adjustments were provided by ORS  
23 witness Hannah K. Majewski.

Adjustment 23 – ORS proposes to adjust for gross receipts and utility/commission taxes associated with the proposed increase. ORS used a factor of .00963081 and the proposed increase of \$40,402, for an adjustment of \$389.

Adjustments 24 – ORS proposes to adjust for state and federal income taxes associated with AAA's proposed rate increase. See Audit Exhibit JWC-4 for the computation of this adjustment.

**Q. PLEASE DESCRIBE THE REMAINING AUDIT EXHIBITS.**

A. Audit Exhibit JWC-3 shows the Depreciation Expense Adjustment. Audit Exhibit JWC-4 shows the Computation of Income Taxes.

**Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

A. Yes, it does.



**AAA Utilities, Inc.**  
**Docket No. 2013-47-W**  
**Operating Experience & Operating Margin**  
**Test Year Ending December 31, 2012**  
**Water Operations**

<u>Description</u>	(1) <u>Application Per Books</u>	(2) <u>Accounting &amp; Pro Forma Adjustments</u>	(3) <u>After Accounting &amp; Pro Forma Adjustments</u>	(4) <u>Applicant's Proposed Increase</u>	(5) <u>After Proposed Increase</u>
<b><u>Operating Revenues:</u></b>					
Unmetered Water	\$ 13,020	\$ 1,590 (1)	\$ 14,610	\$ 6,090 (19)	\$ 20,700
Metered Water	82,842	(8,321) (2)	74,521	34,371 (20)	108,892
Miscellaneous	580	480 (3)	1,060	363 (21)	1,423
Uncollectible Accounts	0	(929) (4)	(929)	(422) (22)	(1,351)
<b><u>Total Operating Revenues</u></b>	<b>\$ 96,442</b>	<b>\$ (7,180)</b>	<b>\$ 89,262</b>	<b>\$ 40,402</b>	<b>\$ 129,664</b>
<b><u>Operating Expenses:</u></b>					
Salaries and Wages	\$ 13,000	\$ 10,368 (5)	\$ 23,368	\$ 0	\$ 23,368
Purchased Water	5,292	0	5,292	0	5,292
Purchased Power	15,608	(470) (6)	15,138	0	15,138
Chemicals	383	0	383	0	383
Contractual Services: Accounting	665	0	665	0	665
Contractual Services: Engineering	4,910	0	4,910	0	4,910
Contractual Services: Lab	9,876	(228) (7)	9,648	0	9,648
Transportation Expense	8,035	(1,121) (8)	6,914	0	6,914
Insurance Expense	9,379	(3,224) (9)	6,155	0	6,155
Repairs	11,581	(1,000) (10)	10,581	0	10,581
Misc. Expense	6,158	182 (11)	6,340	0	6,340
Depreciation	3,786	(741) (12)	3,045	0	3,045
Utility Regulatory Fees	581	279 (13)	860	389 (23)	1,249
Property Tax	697	(162) (14)	535	0	535
Payroll Tax	87	1,808 (15)	1,895	0	1,895
Other Taxes & Licenses	9,200	(750) (16)	8,450	0	8,450
Federal and State Income Tax	326	(3,198) (17)	(2,872)	7,703 (24)	4,831
<b><u>Total Operating Expenses</u></b>	<b>\$ 99,564</b>	<b>\$ 1,743</b>	<b>\$ 101,307</b>	<b>\$ 8,092</b>	<b>\$ 109,399</b>
<b><u>Net Operating Income (Loss):</u></b>	<b>(3,122)</b>	<b>(8,923)</b>	<b>(12,045)</b>	<b>32,310</b>	<b>20,265</b>
Less: Interest Expense	1,539	(1,539) (18)	0	0	0
<b><u>Net Income (Loss) for Return</u></b>	<b>\$ (4,661)</b>	<b>\$ (7,384)</b>	<b>\$ (12,045)</b>	<b>\$ 32,310</b>	<b>\$ 20,265</b>
<b><u>Operating Margin</u></b>	<b>-4.83%</b>		<b>-13.49%</b>		<b>15.63%</b>

AAA Utilities, Inc.  
Docket No. 2013-47-W  
Explanation of Accounting and Pro Forma Adjustments  
Test Year Ending December 31, 2012

ORS Adj.	AAA Adj.	Description	ORS	AAA
<b><u>Accounting and Pro forma Adjustments</u></b>				
<b><u>Operating Revenues</u></b>				
(1)	(1)	Unmetered Water	To adjust unmetered revenue to reflect year end customers at current rates.	\$ 1,590 \$ 2,760
(2)	(2)	Metered Water	To adjust metered revenue to reflect year end customers at current rates.	(8,321) (5,961)
(3)		Miscellaneous	To adjust miscellaneous revenue to reflect late fees.	480 0
(4)		Uncollectible Accounts	To adjust revenue to reflect uncollectible accounts.	(929) 0
<b><u>Total Operating Revenues</u></b>			<b>\$ (7,180)</b>	<b>\$ (3,201)</b>
<b><u>Operating Expenses</u></b>				
(5)	(3)	Salaries and Wages	To adjust the new management contract for increased costs.	\$ 10,368 \$ 10,368
(6)		Purchased Power	To remove the nonallowable expenses per expense sample.	(470) 0
(7)		Contractual Services - Lab	To remove the nonallowable expenses per expense sample.	(228) 0
(8)		Transportation Expense	To remove the nonallowable expenses per expense sample.	(1,121) 0
(9)		Insurance Expense	To remove nonallowable cost related to vehicles and adjust for canceled health insurance and variances in life insurance expense.	(3,224) 0
(10)		Repairs	To remove the nonallowable expenses per expense sample.	(1,000) 0
(11)	(4)	Miscellaneous Expense	To remove nonallowable expenses of (\$2,287) per expense sample and to adjust for rate case expenses amortized over 3 years of \$2,469.	182 750
(12)	(5)	Depreciation	To adjust depreciation for capital improvements and rates recommended by the Water and Wastewater Department.	(741) 807
(13)		Utility Regulatory Fees	To adjust utility regulatory fees to reflect PSC assessments and gross receipt taxes associated with the Company's per book amount.	279 0
(14)		Property Tax	To adjust for property tax regarding a vehicle and other equipment not used for business	(162) 0
(15)	(6)	Payroll Tax	To adjust for payroll associated with the adjustment to salaries and wages.	1,808 1,753
(16)		Other Taxes & Licenses	To remove the nonallowable expenses per expense sample.	(750) 0
(17)		Federal and State Income Tax	To adjust income taxes associated with ORS's accounting and pro forma adjustments. See Audit Exhibit JWC-4.	(3,198) 0
<b><u>Total Operating Expenses</u></b>			<b>\$ 1,743</b>	<b>\$ 13,678</b>
(18)		<b><u>Interest Expense</u></b>	To remove nonallowable interest expense.	<b>\$ (1,539)</b> <b>\$ 0</b>

AAA Utilities, Inc.  
Docket No. 2013-47-W  
Explanation of Accounting and Pro Forma Adjustments  
Test Year Ending December 31, 2012

ORS Adj.	AAA Adj.	Description	ORS	AAA
<b><u>Applicant's Proposed Increase</u></b>				
<b><u>Operating Revenues</u></b>				
(19)	(7)	Unmetered Water	To adjust unmetered water revenues for ORS's recalculation of the Company's proposed increase.	\$ 6,090 \$ 4,920
(20)	(8)	Metered Water	To adjust metered water revenues for ORS's recalculation of the Company's proposed increase.	34,371 35,453
(21)		Miscellaneous	To adjust miscellaneous revenues for ORS's recalculation of the Company's proposed increase.	363 0
(22)		Uncollectible Accounts	To adjust uncollectible accounts for ORS's recalculation of the Company's proposed increase.	(422) 0
<b><u>Total Operating Revenues</u></b>			<b>\$ 40,402</b>	<b>\$ 40,373</b>
<b><u>Operating Expenses</u></b>				
(23)	(9)	Utility Regulatory Fees	To adjust other taxes and licenses to reflect PSC assessments and gross receipt taxes associated with the Applicant's proposed increase.	\$ 389 \$ 378
(24)	(10) & (11)	Federal and State Income Taxes	To adjust income taxes associated with the Company's proposed increase. See Audit Exhibit JWC-4.	7,703 7,699
<b><u>Total Operating Expenses</u></b>			<b>\$ 8,092</b>	<b>\$ 8,077</b>

**AAA Utilities, Inc.**  
**Docket No. 2013-47-W**  
**Computation of Depreciation Expense Adjustment**  
**Test Year Ending December 31, 2012**

Description	Date Purchased	Cost/Basis	ORS Service Life - Years	Depreciation Rates	Depreciation Per Year	Accumulated Depreciation
1 Well -Lakeside Forest	2/29/1996	\$ 3,545	27	3.70%	\$ 131	\$ 2,233
2 Landpoint - New Tanks & Pump house	4/22/1996	4,000	20	5.00%	200	3,417
3 Perry Water System - New water lines	5/1/1996	4,945	15	6.67%	330	4,860
4 Perry Water System - New water lines	1/1/1998	11,500	15	6.67%	767	11,520
5 New Pump - Love Valley	7/25/2002	900	15	6.67%	60	630
6 New Pump - Perry	10/22/2002	2,885	15	6.67%	192	1,968
7 Love Valley - Well & Pump repair	6/17/2004	3,650	15	6.67%	243	2,060
8 New Pumps - Lakeside Forest	7/8/2004	2,060	15	6.67%	137	1,122
9 Landpoint - Water line repair	3/9/2009	3,459	33	3.03%	105	414
10 Perry - New motor	6/24/2006	1,561	15	6.67%	104	711
11 Organizational costs	8/1/1985	2,715	40	2.50%	68	1,974
Additions:						
12 Hilton Sound - Dry Hole	3/18/2013	4,500	15	6.67%	300	300
13 Hilton Sound - Rock Well	3/18/2013	2,580	27	3.70%	96	96
14 Hilton Sound - Well Infrastructure	3/18/2013	798	27	3.70%	30	24
15 Hilton Sound - Well Pump	2/5/2013	4,233	15	6.67%	282	288
Totals		\$ <u>53,331</u>			\$ 3,045	\$ <u>31,617</u>
Per Books					\$ <u>3,786</u>	
Depreciation Expense Adjustment - (12)					\$ <u>(741)</u>	

**AAA Utilities, Inc.**  
**Docket No. 2013-47-W**  
**Computation of Income Taxes**  
**Test Year Ending December 31, 2012**

**After Accounting & Pro Forma Adjustments**

**Description**

Operating Revenues	\$ 89,262
Operating Expenses	<u>104,179</u>
Net Operating Income before Taxes	(14,917)
Less: Annualized Interest Expense	<u>0</u>
Taxable Income - State	(14,917)
State Income Tax Rate	<u>5.00%</u>
State Income Taxes	\$ <u>(746)</u>
Taxable Income - Federal	(14,171)
Federal Income Tax Rate	<u>15.00%</u>
Federal Income Taxes	\$ <u>(2,126)</u>
Total State and Federal Income Taxes	(2,872)
Less: Income Taxes Per Book	<u>326</u>
Adjustment to Income Taxes - ORS Adjustment (17)	\$ <u>(3,198)</u>

**After Applicant's Proposed Increase**

**Description**

Operating Revenues	\$ 129,664
Operating Expenses	<u>104,568</u>
Net Operating Income before Taxes	25,096
Less: Annualized Interest Expense	<u>0</u>
Taxable Income - State	25,096
State Income Tax Rate	<u>5.00%</u>
State Income Taxes	\$ <u>1,255</u>
Taxable Income - Federal	23,841
Federal Income Tax Rate	<u>15.00%</u>
Federal Income Taxes	\$ <u>3,576</u>
Total State and Federal Income Taxes	4,831
Less: Income Taxes As Adjusted	<u>(2,872)</u>
Adjustment to Income Taxes - ORS Adjustment (24)	\$ <u>7,703</u>